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May 30, 2007

Dear Andrew,

Re: The Entry Capacity Transfer and Trade Methodology Statement

This Methodology Statement was raised in support to and accompanying UNC Modification Proposals 0150 & 0151. It should be noted that our comments offered in response to this consultation should not be interpreted as indicating support for either Mods 0150 or 0151. As Proposer of alternative Proposals on entry capacity trades and transfers, it is our view that this Methodology Statement would need to be substantially revised (and re-consulted upon accordingly) in order to support Mods 0150A or 151A, if implemented.

In the case of Mods 0150 & 0151, it was not clear from the Proposal how they would actually work in practice until the Methodology Statement was released at a later date. This has, we believe, undermined confidence in NG's UNC Modification Proposals. We believe there is a strong case for including as much of the detail of the Proposals as possible within a Modification Proposal. The process to date has highlighted clear deficiencies in the current arrangements governing supporting Methodology Statements. Nonetheless, we recognise the unfortunate situation that we are in and accordingly offer the following comments on the draft statement.

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Our Specific Comments on the Methodology Statement:

1. It is our firmly-held belief that, if Mods 0150 and/or 0151 are implemented, NG NTS should publish a matrix of exchange rates that are valid for one year, together with nodal maximum for each ASEP (and possibly zonal maximum). Some ASEPs could be grouped together (e.g. into the zones) to minimise the size of the matrix. The lack of *ex-ante* exchange rates will be a huge disincentive for Shippers to participate in any trade or transfer process. Whilst we fully appreciate the complexity of deriving individual exchange rates based on the assumptions put forward in this Methodology Statement, we believe the process as drafted is overly complex, costly, time-consuming and too risk-averse to achieve a useful outcome for Users. To overcome these difficulties, we strongly advocate adoption of fixed 1:1 transfer rates for transfers and trades within NG 10YS “zones”, as previously proposed by NG NTS in UNC Modification Proposal 0118 and also in 1999 as Transco in Mod 0127 (TED and THREAD), which proposed combining ASEPs within entry zones for auction purposes. As demonstrated in responses to the UNC Modification Proposals on transfers and trades, many Users see merit in the use of fixed 1:1 transfer rates within zones and we firmly believe this is the most pragmatic way forward.
2. In para. 15, the flow chart shows that only transfers that have zero incremental risk attached to them will be ‘allowed’. This doesn’t appear to be consistent with the Licence Obligation to avoid “undue” increases in costs. Only allowing transfers that have zero incremental risk will severely limit the extent to which the process can, and will, be used. It is not unreasonable to assume that, as a result, only transfers and trades between a small selection of ASEPs will be possible.
3. In para 19, it is stated that:

“The most significant constraint on capacity exchange rate is the requirement for National Grid to avoid increases in the costs that can reasonably be expected to be incurred as a result of capacity being reassigned. This includes, but is not limited to, capacity buy-back costs.”¹

It is not clear what the “other” costs referred to here. The statement needs to be more specific so that particular costs can be identified, which would support greater transparency and industry confidence in the process for transfer rate determination.

¹ Our underlining.

4. For transfers through a transfer auction, we suggest that the additional revenue from the auction could be factored-in to offset the potential buy-back risk. It is acknowledged that currently the buy-back incentive mechanism may not recognise this extra revenue, but this is hardly economic and efficient, and suggests that a change may need to be made to the incentives so that the additional capacity revenue goes into the buy-back 'pot'. This would reduce the potential risk faced by NG, thereby potentially releasing more capacity for transfer or trade. Nonetheless, it remains wholly unsatisfactory that the release of entry capacity should ultimately be constrained by possible deficiencies in the buy-back incentives mechanism, rather than actually being representative of the physical capability of the network (as per the Licence Obligation).
5. In para. 21, baseline flows should be considered at the recipient ASEP, as this is the basis on which Ofgem have set National Grid's allowed revenue. In addition, only a peak flow winter model (as opposed to forecasts and multiple scenarios) should be used, which is consistent with how the revised TPCR baselines were set on a zonal basis.
6. In para. 22, we would appreciate clarification on whether National Grid intends to make the 'simple algorithm' available to Users (e.g. like the IECR model is). Users would find this very useful.
7. There is a presumption in the Statement that an exchange rate will never be better than 1:1. We do not understand why this is and can see no obvious justification for its inclusion. Placing an artificial limit on supposedly "bespoke" exchange rates is inefficient and uneconomic and appears aimed more at minimising NG risk than optimising release of entry capacity. We would strongly advocate removal of this "limit", as we believe it fails to recognise the physical characteristics of the network.

Specific comments on points raised in the Covering Letter to the Methodology Statement:

8. For trades, our suggestion is that there is no need to place a limit on the minimum amount of capacity that could be transferred to a recipient ASEP. The User will have had to buy capacity at the donor ASEP (for at least the reserve price) and if they are prepared to transfer on such a low exchange rate, then that is a commercial decision for the User to make and not for the Transporter to dictate.

9. For transfer auctions, we suggest that the effective price at the donor (i.e. bid price at recipient divided by the exchange rate) should exceed the reserve price at the donor. We appreciate, however, that this can only be dealt with in the UNC Modification Proposal(s) on how bids are allocated; not in this Methodology Statement.

Overall, we consider that this Methodology Statement in conjunction with UNC Modification Proposals 0150 & 0151 will unfortunately fail to meet pressing market needs and will not prevent sterilisation of entry capacity. For clarity, we are unlikely to support any Methodology Statement on this subject until a fixed 1:1 exchange rate within “zones” is adopted for transfers and trades and this principle becomes entrenched in the UNC.

Please feel free to contact me on 02476 181421, if you wish to discuss any of the points raised above.

Yours sincerely

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